On the 2022 nom/gov committee agenda

KPMG Board Leadership Center

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Moving into 2022, the issues in the nominating and governance (nom/gov) committee's purview have grown exponentially in importance. While the global pandemic called for urgent attention to board procedures and processes, the social justice movement that followed the murder of George Floyd heightened the focus on board diversity as well as workforce diversity, equity, and inclusion (DEI). All the while, scrutiny of how companies establish, communicate, and meet ESG goals—including those related to climate-change strategy and risk, racial equity, worker well-being, and more—has been intensifying.

As the board's oversight role expands to include new areas of responsibility—and the number and length of board meetings grows along with the ubiquity of virtual meetings—nom/gov committees are charged with reevaluating the board's culture and dynamics, processes and procedures, composition, committee structure, and communications with shareholders and stakeholders. Once in the background, the nom/gov committee's role has taken center stage.

Drawing on our research, insights, and interactions with nom/gov committees and business leaders, we highlight six issues to keep in mind as nom/gov committees consider and carry out their 2022 agendas:

— **Assess the board's processes and procedures for the long term, drawing on learnings from COVID-19-related adjustments.**

— **Promote comprehensive board oversight and consistent stakeholder communication on ESG.**

— **Evaluate how the board will acquire the skills needed to address gaps in light of the rapidly changing business and risk environment.**

— **Accelerate progress on board diversity and related disclosures.**

— **Examine the board's oversight of mission-critical areas and related documentation.**

— **Maintain focus on the core work of the committee.**

Assess the board's processes and procedures for the long term, drawing on learnings from COVID-19-related adjustments.

2020 was a real-world exercise in adjusting board processes to suit a crisis, and 2021 was a mix of back to normal, back to shutdown, and everything in between. Rather than simply returning to a prepandemic cadence—whatever that may mean for a particular board—2022 is a good time to take a deep dive into the question of what makes for a great board in the current environment and into the future. This assessment should consider board culture and dynamics as well as agendas, meeting cadence, and processes. Strive to retain the best of both prepandemic and pandemic experiences while focusing on future needs and incorporating flexibility to quickly adjust procedures as circumstances evolve.

Start by looking at what makes for quality board discussions. Consider Adam Grant's concept of "thinking like a scientist." Grant suggests viewing strategy as a hypothesis, or a bet on the existence of a particular world, which must be tested and adapted. In a boardroom setting this may include:[1]

— Encouraging individuals to dig below the surface to bring a range of ideas and considerations to the table before discussion, including black swan events

— Setting a tone that encourages management and board members to admit what they don't know

— Allocating time for "rethinking and unlearning" to assess and learn from what went right as well as what went wrong

— Focusing on slow-moving but pivotal shifts as well as those that are more immediate.

Does the culture of the board embody these concepts and cascade them into the organization by influencing management? How can the nom/gov committee move the board in this direction as it considers board structure, agendas, board education, and interaction with the C-suite and below?

More tactically, what is the right mix of virtual and in-person meetings once the pandemic is no longer influencing these decisions? Virtual meetings save time, money, and environmental impact, and many boards are considering retaining them for the more routine aspects of board and/or committee meetings. In-person meetings not only allow for assessing body language but also the informal observations and serendipitous discussions that can take place during shared meals, travel, and breaks. These "softer" considerations can have a tremendous impact, and a focus on how location, time, and cadence influence board dynamics and decision-making can serve the board well moving forward.

Promote comprehensive board oversight and consistent stakeholder communication on ESG.

ESG encompasses a multitude of issues touching on corporate purpose, strategy, risk, and talent—and it's the nom/gov committee's responsibility to ensure the board is allocating proper oversight to this expanding area of board focus. The issues are sweeping enough that the full board and every committee should be involved in some aspect of it; compensation committees address issues including DEI and workforce wellness as well as ESG-related compensation incentives; audit committees address ESG-related disclosure controls and risk; and for the full board, ESG should serve as an important lens for discussions of strategy, risk, capital allocation, and leadership.

The nom/gov committee's role concerns shareholder engagement on the topic and an ESG lens on the composition, structure, and decision-making practices of the board. It is also critical for the committee to stay on top of the broad scope of evolving issues, to look out for overlaps and gaps, and promote collaboration among the board and committees. Some boards establish a separate committee to take a deep dive into the issues, while others house this responsibility within an existing committee, most commonly the nom/gov committee. The structure may vary, but given the importance of these issues, they should be on the agenda in every boardroom and board committee.

In 2021, institutional investors showed increasing willingness to take action and replace directors when it comes to ESG issues. Investor focus on climate-change risk, board diversity, and workforce DEI is expected to continue into the 2022 proxy season. That the proxy voting guidelines of several investors go so far as to recommend votes against the nom/gov chair, entire nom/gov committee, or sometimes all incumbent directors for lack of board diversity and/or disclosure, underscores the seriousness of their resolve. And activist investors are increasingly positing alleged lack of board effectiveness with regard to the strategic implications of climate change as a basis for seeking board turnover. Nom/gov committees should take a hard look at how the board measures up on composition, risk oversight, and incorporation into strategy of the ESG-related topics of greatest importance to the company's most significant investors.

Of course, investors are not the only stakeholders interested in ESG. More than half (61%) of respondents to the 2021 KPMG U.S. CEO Outlook indicate that their principal objective is to embed purpose into everything they do to create long-term value for all stakeholders. Employees, particularly younger ones, consider a company's approach to ESG a differentiator in the war for talent,[2] and the rise of consumer-facing products featuring some aspect of ESG in their marketing is indicative of its importance to customers.[3] As companies engage these stakeholders, the nom/gov committee can assess the consistency of the company's ESG story across different communication channels and the consistency of its public messaging with the actual progress being made.

Evaluate how the board will acquire the skills needed to address gaps in light of the rapidly changing business and risk environment.

The dramatic acceleration of megatrends in recent years has demonstrated how quickly the skill sets required of the board can shift. 2022 is poised to demand attention to issues including supply chain volatility, inflation, the implications of the workforce shift known as the "great resignation," ethical questions posed by the use of technology, heightened cyber risk, and a keen focus on ESG—including climate change, workforce wellness, DEI, and company positions with regard to social justice and public policy issues—with other critical topics likely to arise as the year goes on.

The nom/gov committee is charged with aligning board skills to the needs of the company, and while a long-term view is essential, the events of the past year may expose gaps in experience relevant to some shorter-term issues as well. Reevaluate the skills, experiences, and education the board needs to provide oversight and guidance on the critical issues relevant to the company's short-term and long-term strategies. What new issues are so material to the company's business that one or more directors with specific expertise may need to be added to the board? For which issues is the board better served by reliance on a third-party expert? And if there is not a board member or third-party advisor with deep expertise on a relevant topic, how will the board collectively gain knowledge sufficient to provide appropriate oversight? According to a 2021 Spencer Stuart survey, over the next three years, nom/gov committees are prioritizing recruitment of directors with global perspectives/experience (43%) and directors with technology experience (40%), among other skill sets.[4]

Nom/gov committees should consider whether board turnover will be sufficient in the coming years to create space for directors who add needed expertise and experience to the board. While the number of board seats can be expanded to accommodate new members, it is the nom/gov committee's role to reinforce that directorship is not a lifetime commitment. Nom/gov committees—along with lead directors—should strive to develop and enforce a board culture where annual proxy slate decisions based on diversity of relevant skill sets, backgrounds, and tenures are expected, and there is no stigma attached to rotating off a board long before retirement age.

Accelerate progress on board diversity and related disclosures.

Assessing the board's composition for diversity of gender, race or ethnicity, and sexual orientation in light of the company's diversity goals and related shareholder expectations should be viewed alongside the board's assessment of skill sets as a matter of table stakes. Because of the business value of diverse perspectives, pressure continues to mount for increasing diversity and also for disclosure—from institutional investors, state governments, proxy advisory firms, and other stakeholders. In addition, California's AB 979 mandate and Nasdaq's new Board Diversity Rule—both of which promote the inclusion of racially or ethnically diverse and LGBTQ+ directors on the board—are set to make an impact as boards gear up for compliance.[5] Other considerations with respect to board diversity may include veteran status, disability, socioeconomic background, nationality, and generation/age.

The Nasdaq and California rules have focused on increasing board diversity by including directors who are female, Black, Hispanic/Latino, Asian, and/or LGBTQ+ in the boardroom mix. Given the spending power and size of these groups among employees, consumers, and the overall population, there is a long way to go. KPMG BLC research shows that among public Fortune 1000 boards, Black representation stands at 8%, with Asian representation at 4%, and Latino representation at 3%; all groups are underrepresented when compared to the overall U.S. population.[6] Women have been moving into the boardroom in greater numbers over the years, yet according to the 2021 Q3 Gender Diversity Index released by Equilar, women still hold only 26% of Russell 3000 directorships.[7]

In addition, only 1% of Russell 3000 boards and 3% of S&P 500 boards disclose the LGBTQ+ status of individual directors.[8] And disclosure tends to be the norm in larger companies only. For example, only 43% of Russell 3000 companies under $100 million in revenue disclose the board's racial or ethnic diversity—either by individual director, in the aggregate, or both—compared to 82% of Russell 3000 companies with a revenue of $50 billion and over.[9]

With board diversity and related disclosure now a baseline expectation, nom/gov committees may consider their approach to diversity with the following questions:

— How does the board define diversity? Does the definition take into account applicable laws/regulations/investor policies and also the demographics of the company's customers, employees, and other key stakeholders? Is demographic diversity a key component of the board matrix or is it an afterthought?

— How is diversity incorporated into the director recruitment process? Does the nom/gov committee insist on highly diverse candidate pools to avoid tokenism? How are directors working closely with search firms and engaging with diverse director membership organizations and other organizations to expand their networks and broaden their candidate pools?

— Has the profile for director searches been updated to capture potential candidates with relevant but nontraditional backgrounds and skill sets? Is diversity an aspect of every search, to avoid a "once and done" approach?

— How is the company telling its story publicly? Has the company adopted and disclosed a strong board diversity policy? Are board members asked whether they wish to self-identify for purposes of the proxy? Does the proxy disclosure provide a clear snapshot of the board's diversity? Has individual director diversity disclosure been adopted? How do the company's disclosures compare to leading practices, and are the disclosure frameworks updated as expectations evolve?

Examine the board's oversight of mission-critical areas and related documentation.

As fiduciaries, board members need to understand their fiduciary duties, and the nom/gov committee should assess the board's oversight practices with legal counsel to help ensure the practices are keeping pace with legal developments as well as the changing business environment. Every nom/gov committee should be receiving briefings from the general counsel or external counsel on the Delaware court opinions addressing application of the duty of care. As most corporate directors are aware, a case for breach of this duty is extremely difficult to make given the protection of the business judgment rule.

Two recent cases, however, show the growing importance of the board's oversight processes when it comes to safety risks, including one filed in 2019 involving an outbreak of Listeria in ice cream and the other currently pending in the aftermath of airplane crashes. In these cases, the Delaware courts entered into decisions with regard to the boards of the companies that manufactured the products, with considerations that should be used as guidance for all boards as they provide oversight of "mission-critical" risks affecting health and safety. Some of the issues raised by the allegations of these complaints highlighted by the court include:

- No board committee was charged with direct responsibility to monitor product safety, and the board at large was not formally monitoring or discussing safety on a regular basis.
- Following an air crash, the (not yet proven) allegations included statements that the agenda for an upcoming board meeting reflected discussion items for restoration of profitability and efficiency but not safety.
- Among other indicators noted, the board is alleged to have passively accepted management's assurance of product safety and it did not take action in the face of red flags, including the crash itself and a media article describing engineering defects.[10]

As numerous law firms have urged, boards should make sure that they not only have the structure and processes in place to provide effective oversight but also that the agendas and minutes demonstrate the work that is being done. As the nom/gov committee works to continuously improve overall board effectiveness, it is critical to work with legal counsel to ensure that the structure, practice, and documentation consistently demonstrate appropriate board attention to mission-critical risks.

Maintain focus on the core work of the committee.

Given the increasing number and complexity of topics requiring board attention, the role of the nom/gov committee in promoting board effectiveness has never been more important. Heading into 2022, nom/gov committees should review their own composition, charters, and workload to optimize the committee's scope and processes. In conducting its review, the nom/gov committee will want to make sure it is not losing sight of the important ongoing functions of the committee, including:

- **Board composition/director succession:** In addition to the skill set and diversity considerations discussed previously, does the nom/gov committee routinely review and update the succession plans for the board chair, lead director, and committee chairs—both as a matter of immediate turnover and for longer-term planning?
- **Evaluations:** Is the evaluation process consistent with leading practices? What are the overall takeaways from board and committee evaluations? Does the board perform individual director evaluations? What is the process for identifying and implementing improvement measures?
- **Director compensation:** How does director compensation align with current compensation trends and investor expectations? If director compensation is determined by the compensation committee, how does the work of the nom/gov committee help inform its view?
- **Committee structure/composition:** Are all critical issues accounted for on the agenda—either at the full-board level or one or more committees? Should any new committees, either standing or ad hoc, be created? If a committee is no longer highly active, should it be disbanded? Is the workload across the committees reasonable, and, if a committee is overloaded, where else can part of its workload be allocated? Is there communication among committees to expose gaps and collaborate on issues that overlap?
- **Shareholder/stakeholder engagement:** Does the nom/gov committee have the skill to provide guidance and oversight of the company's approach to investor engagement? Are the lead director and key committee chairs willing and able to engage with investors directly as appropriate? Is there a process to educate the board on investor perspectives about the company (positive and negative), as well as evolving trends in shareholder activism?
- **Continuing education:** How does the nom/gov committee encourage and support director education to enable the board to stay on top of key issues and emerging trends in board governance and the business environment?

[1] Adam Grant, "Think Again: The Power of Knowing What You Don't Know," (New York: Viking, 2021). Adam Grant, "Think Again: The Power of Knowing What You Don't Know," NACD Summit 2021, October 4, 2021.

[2] Adele Peters, "Most millennials would take a pay cut to work at [an] environmentally responsible company," Fast Company, February 14, 2019.

[3] Sebastian Gatzer and Clarisse Magnin, "Prioritizing sustainability in the consumer sector," McKinsey & Company, August 5, 2021.

[4] Spencer Stuart, Nominating/Governance Chair Survey 2021.

[5] As a follow-up to California's SB 826, which mandates women on boards, California's AB 979 will require public companies headquartered in California to have one or more directors—depending on board size—who self-identify as racially or ethnically diverse or LGBT. Nasdaq's Board Diversity Rule will require most companies listed on its U.S. exchange to have at least two diverse directors (or disclose why they do not), with at least one director self-identifying as female and at least one director self-identifying as either LGBTQ+, or racially or ethnically diverse. Such demographic data must be disclosed in a Board Diversity Matrix. Both California's AB 979 and Nasdaq's rule include the following racial or ethnic categories in their definitions of "underrepresented communities" and "underrepresented minorities," respectively: Black/African American, Hispanic/Latino, Asian, Pacific Islander, Native American, Native Hawaiian, and Alaska Native.

[6] These data points are drawn from three independent research reports conducted by the KPMG BLC in collaboration with the African American Directors Forum, Ascend Pinnacle, and the Latino Corporate Directors Association, respectively. The lists of Fortune 1000 directors forming the basis for the research, identified as of specific points in time, may vary slightly among the three reports. KPMG BLC, Asian representation on Fortune 1000 boards, 2020. KPMG BLC, Latino representation on Fortune 1000 boards, 2021. KPMG BLC, African American representation on Fortune 1000 boards, forthcoming.

[7] Equilar, Inc., Q3 2021 Equilar Gender Diversity Index, October 28, 2021.

[8] KPMG Board Diversity Disclosure Benchmarking Tool, powered by ESGAUGE. Data as of September 2021. See also Annalisa Barrett and Susan M. Angele, "Boards Expand Racial and Ethnic Diversity Disclosure," The Power of Difference, National Association of Corporate Directors, November 2021.

[9] KPMG Board Diversity Disclosure Benchmarking Tool, powered by ESGAUGE. Data as of September 2021.

[10] Stephen A. Radin and Joshua Glasser, "Boeing Decision Underscores Need for Board Oversight of 'Mission Critical' Product Safety Risks – And Documentation Demonstrating This Oversight," Governance & Securities Watch, Weil, Gotshal & Manges LLP, September 13, 2021.

About the KPMG Board Leadership Center

The KPMG Board Leadership Center (BLC) champions outstanding corporate governance to drive long-term value and enhance stakeholder confidence. Through an array of insights, perspectives, and programs, the BLC—which includes the KPMG Audit Committee Institute and close collaboration with other leading director organizations—promotes continuous education and improvement of public and private company governance. BLC engages with directors and business leaders on the critical issues driving board agendas—from strategy, risk, talent, and ESG, to data governance, audit quality, proxy trends, and more. Learn more at kpmg.com/us/blc.

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